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LIABILITY OF BANK AFTER PAYING CHECK FRAUDULENTLY RAISED BY FILLING SPACES LEFT IN DRAWING

The drawer issues a check in which are spaces before and after the words and figures indicating the amount. The spaces are filled by another without authority from the drawer, and the amount is thus raised without giving the check an appearance to excite suspicion. Can the drawee bank, which in good faith pays the raised check, charge the entire amount against the drawer?

Ninety years ago *Young v. Grote*[1] answered this question in the affirmative. A case recently decided by the English Court of Appeal reaches the opposite conclusion, affirming the judgment of the lower court which found that the drawer was not guilty of any negligence which misled the bank, and if he was guilty of negligence, the

[1] (1827 Eng. C. P.) 4 Bing. 253. *Accord, Timbel v. Garfield Nat'l Bank* (1907, N. Y.) 121 App. Div. 870; 106 N. Y. Supp. 497. See also 8 C. J. 734 for conflict as to application of *Young v. Grote* to actions by innocent purchasers against acceptors, makers and endorsers.

negligence did not cause the loss. *Macmillan v. London Joint Stock Bank* (C. A.) [1917] 2 K. B. 433.

The bank and the drawer stand in the relation of debtor and creditor. The bank by the contract acquires the power of discharging its debt by paying genuine orders, and is also under a duty to honor genuine orders or answer in damages. The depositor has entirely within his control the creation of an existing state of facts which will compel the performance of the bank's duty to him and enable the bank to exercise its power of discharging its debt to him. In the instant case the bank has attempted to exercise its power in reliance on an appearance of the existence of those facts, which appearance has resulted from a third party's criminally taking advantage of the drawer's failure to observe the ordinary business methods intended to prevent such crimes. It is legally possible to place the responsibility for the resulting loss on the depositor in several ways. We may say the bank under the circumstances acquired no power so to discharge its debt, but can hold the depositor in tort for damages for the difference between the genuine and raised check; or, to avoid circuity of action, allow the bank to use its right of action as a set-off in the action by the depositor against it. But the most direct way of placing responsibility on the drawer is to say that the bank under the circumstances has the power to discharge its debt by honoring the raised order. If we adopt this conclusion we in effect say that a change in the legal relations of bank and depositor has resulted from the wrongful act of the holder in filling in the spaces. It is clear that the holder had no *right* to collect the check when raised for the drawer was not under any duty to him after the check had been altered; nor had he the *privilege* of collecting, for he was under a duty to the drawer not to collect more than the amount of the original check. Then responsibility for the results must be placed on the depositor because, in view of his acts, a *power* is given the holder by law to subject the depositor to the *liability* of being divested of his legal rights under his contract with the bank. Professor Hohfeld has thus described legal powers: "A change in a given legal relation may result from . . . some superadded fact or group of facts which are under the control of one or more human beings," in which case, "the person whose volitional control is paramount may be said to have the (legal) power to effect the particular change of legal relations that is involved in the problem."[2] Again, "legal powers and correlative liabilities involving the divesting of legal and equitable rights in rem (and other jural relations belonging to the particular aggregates involved) have existed from the earliest times. Such powers are created by the law on various grounds

[2] Prof. Wesley N. Hohfeld, *Fundamental Legal Conceptions* (1913) 23 YALE LAW JOURNAL 16, 44.

of policy and convenience."[3] The problem then is simply one of the naked legal *power* of the wrongdoer and the correlative *liability* of the drawer.

An examination of the *powers* thus described shows, first, that the exercise of the power divests legal rights and does not merely give rise to liability *ex delicto*. P through A as agent loans money to T and leaves T's note and mortgage in A's possession but gives A no authority to collect. Payments made by T on account discharge the debt *pro tanto*.[4] Again the maker of a bearer note who pays it at maturity in good faith to the thief in possession has discharged his debt to the true owner.[5] Second, the law does not create the power because of negligence on the part of the person whose legal relations are changed by its exercise. The power of the thief to give an indefeasible right to the purchaser in good faith of negotiable bonds payable to bearer stolen from the owner's safe is not created by law because of the owner's negligence in the manner in which he kept the bonds, but simply in view of the fact that he failed to retain them in his possession.[6] The liability of a partner on new contracts made by his associates after dissolution is not because of his negligence in failing to give notice, for it is immaterial that sufficient time has not elapsed in which to give notice,[7] or that reasonable efforts have been made to give notice.[8] There is of course no agency in fact, but a power given by the law on grounds of business policy. Third, the act or omission of the person against whom the power is exercised need not be the "proximate cause." It is sufficient if it is in the chain of causation and the circumstances are such that sound policy and business convenience require that the power be given.

In each of the above illustrations there is the intervention of the independent wrongful acts of the one exercising the power, and in some instances the acts are criminal. To say that the drawer is not responsible because he is not guilty of negligence, and that even if he is negligent, the crime, not the negligence, is the "proximate cause," is to leave unanswered the question, whether the law should not, in situations like the one under consideration, as a matter of business convenience and in the interest of fair dealing, give the holder the power, by certain acts, to confer upon the bank the power of discharging its debt to the drawer by honoring the raised instrument.

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[3] *Fundamental Legal Conceptions* (1917) 26 YALE LAW JOURNAL 710, 756. See also Prof. Walter W. Cook, *Powers of Court of Equity* (1915) 15 COLUMBIA L. REV. 228, 251.

[4] *Crane v. Gruenewald* (1890) 120 N. Y. 274, 24 N. E. 456.

[5] *Greve v. Schweitzer* (1875) 36 Wis. 554. N. I. L. secs. 88, 119.

[6] Professor Underhill Moore, *Theft of Incomplete Negotiable Instrument and Negotiation to a Holder in Due Course* (1917) 17 COLUMBIA L. REV. 617.

[7] *Bristol v. Sprague* (1832, N. Y. Sup. Ct.) 8 Wend. 423.

[8] *Austin v. Holland* (1877) 69 N. Y. 571.

The problem being one of business convenience and policy, its solution must depend largely on the actual method by which the bank of necessity conducts its checking business, the business world's conduct and understanding in the premises, and the economic policy of both law and business of encouraging as far as possible the use of this species of credit as a substitute for money in the transaction of business.

The bank is not in the position of the ordinary debtor. The latter may refuse to pay an agent at all or postpone payment until direct inquiry has been made of his principal as to the agent's authority. In either event he has not increased his legal liability, and, as the transaction is more or less isolated, the business world does not suffer. On the other hand the bank must act immediately and act only on the appearance of the check itself. The bank cannot refuse to honor genuine checks if there are funds of the depositor's on hand, without subjecting itself to an action for damages for injury to his credit. It cannot inquire of each of its thousands of depositors as to the validity of each check. Not only would this be impracticable, but the delay would be intolerable to the business world and would end the usefulness of checks as a quick means of transferring credits.[9]

That the business world appreciates the bank's situation and the necessity of guarding against check raising is clear from the almost universal practice of drawing lines in spaces, if any, before and after the words and figures fixing the amount the check calls for, and from the now common use of cutting and stamping devices to indicate the amount. Business men know that erasures by chemicals or other means leave tell-tale marks in the check and that when a check is so drawn that it can be raised without making erasures, by merely filling spaces, the bank is deprived by the carelessness of the drawer of its most important means of detecting an alteration. It is probably true that these precautions are due mostly to an understanding among business men that the responsibility for losses resulting from loosely drawn checks falls on the drawer, an understanding which accords with the opinions of most of the leading text writers. To place the responsibility on the drawer would seem to mean simply bringing the law into accord with the business world's conduct and understanding of what the situation demands.[10]

J. W. E.

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[9] *Glennon v. Rochester Trust, etc., Co.* (1913) 209 N. Y. 12, 102 N. E. 537, holding that the administrator of a depositor could not recover from the bank the amount of a check drawn by the intestate but paid after his death, of which the bank was ignorant. In effect, the court, on grounds of business policy, gives the holder of the check a power which will divest the legal rights of the administrator. *Leighton v. Bank* (1917, Mass.) 116 N. E. 414 (insane drawer); *Riley v. Albany Savings Bank* (1885, N. Y. Sup. Ct.) 36 Hun 513.

[10] *Commercial Bank v. Arden* (1917, Ky.) 197 S. W. 951, reported since the above was written, holds that the drawer, under facts like those of the principal